Part 2 Contract Law CHAPTER 11 Capacity and Legality Page 237 CASE OPENER Apple’s Questionable Contract Parents of minors took Apple to court in 2012 for supplying game applications on iPhones that were free but through which users could purchase in-game currencies. Apparently, parents would log on to the games, but within a subsequent 15-minute time frame, the minors using the game would rack up bills ranging from $99.99 to $338.72 at a time. Apple stated that although minors were downloading these applications and in-game currency, the contract in question was actually the Terms of Service between the parents and Apple. According to the Terms of Service, any unauthorized log-on on one’s account or unauthorized purchases by anyone on the account was the responsibility of the account holder. On the other hand, the parents argued that all application and in-game purchases made by minors were separate contracts that may be disaffirmed by a parent or guardian. Apple also argued that a contract as the parents were describing it could not legally exist in that, as the parents described the scenario, the contractual offer was made to parents in the Terms of Service, yet accepted by the children, and consideration was provided by the parents (the original offerees).1 Do the individual purchases made by the minors indeed qualify as separate contracts between Apple and the minors? Even if the purchases were contracts between the minors and Apple, could the parents void these contracts? LEARNING OBJECTIVES LO 11-1 Recognize circumstances wherein a minor would have a limited capacity to enter into a contract. LO 11-2 Explain how a contract created when one is a minor may be ratified after one is no longer a minor. LO 11-3 List the conditions under which a contract is unenforceable by law. LO 11-4 Describe instances in which unfairness affects a contract’s enforceability. LO 11-5 Recall the legal effect of entering into a contract for illegal purpose. LO 11-6 Describe the characteristics of a severable contract.

Capacity This chapter examines the third and fourth elements of a contract. Capacity is the third element of a legally binding contract. A person who has legal capacity to contract is one who has the mental ability to understand his or her rights and obligations under a contract and therefore will presumably be able to understand how to comply with the terms of the agreement. Incapacity, or incompetence, as it is sometimes called, is some sort of mental or physical defect that prevents a natural person from being able to enter into a legally binding contract. Depending on the nature and extent of the defect, a person may have either no capacity, and therefore any

attempted contract is void, or limited capacity, resulting in the ability to form only voidable contracts. Historically, people with limited or no capacity included married women, minors, and insane persons. Through statutes, other categories were added for classes of people for whom guardians had been appointed, such as habitual drunkards, narcotic addicts, spendthrifts, the elderly, and convicts. Today, married women have been removed from the category of those lacking contractual capacity, although in a few states their capacity to enter into certain kinds of contracts is still limited. In this section of the chapter, we explain the current law limiting the capacity of some categories of persons to enter into legally binding agreements. Exhibit 11-1 summarizes these various types of incapacity. Minors LO 11-1 Recognize circumstances wherein a minor would have a limited capacity to enter into a contract. One of the oldest limitations on capacity is the ability of minors to enter into only voidable contracts. Today, in all but three states, a minor is someone under the age of 18.2 In most states, however, a person is given full legal capacity to enter into contracts when he or she becomes emancipated before reaching the age of majority. Emancipation occurs when a minor's parents or legal guardians give up their right to exercise legal control over the minor, typically when the minor moves out of the parents' house and begins supporting himself or herself. Often the minor will petition the court for a declaration of emancipation. In most cases, when minors marry they are considered emancipated. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Let's say that in the Case Opener the court decided that all of the purchases made by the minors were indeed contracts between the minors and Apple. Let's say that the parents attempted to void the contracts themselves because they are technically the minors' legal guardians. Would such a move be legal? Why or why not? Disaffirmance of the Contract Because their contracts are voidable, minors have the right, until a reasonable time after reaching the age of majority, to disaffirm, or avoid, their contracts. No formalities are required to disaffirm the contract; the minor need only manifest an intention to rescind the contract, either by words or by actions. However, the minor must avoid the entire contract; they cannot choose to disaffirm only a portion of it. Case 11-1 provides an illustration of how the court sometimes grapples with the issue of whether to allow a minor to disaffirm a contract. Page 239 CASE 11-1 ADRIAN LOPEZ v. KMART CORPORATION United States District Court for the Northern District of California 2015 U.S. Dist. Lexis 58328 (2015) FACTS: In April of 2013, Kmart hired Adrian Lopez as a cashier in its Concord, California, store. At the time, Lopez was 16 years old and a sophomore in high school. Before Lopez began working, he was required to participate in Kmart's online

training program. During the program, Lopez was presented with an electronic arbitration agreement. The agreement stipulated any disputes Lopez might have with the company were to be handled out of court in arbitration. Lopez electronically signed the agreement and acknowledged his receipt of the agreement. In January of 2015, one month after his 18th birthday, Lopez filed a class action complaint against Kmart alleging violations of California wage and hour laws. Kmart filed a motion to compel arbitration. Lopez contended that, because he was a minor when he acknowledged the agreement, he is now entitled to disaffirm the agreement and render it void, thus allowing Lopez to pursue his claim in court. QUESTION: Did Lopez have the right to disaffirm the agreement due to him being a minor when he signed it? REASONING: To begin the case, the district court found that the arbitration agreement was indeed valid but acknowledged that this fact hardly mattered if Lopez had the right to disaffirm the agreement. The court had to find whether Lopez was entitled to disaffirm the arbitration agreement or if he even had the capacity to enter into the agreement at all as a minor. The court found that the California Family Code clearly provides that a minor has the capacity to contract, and that "[e]xcept as otherwise provided by statute, a contract of a minor may be disaffirmed by the minor before majority [age 18] or within a reasonable time afterwards[.]" Lopez claimed disaffirmance within a month of reaching the age of majority, which the court found to be a reasonable period of time. The court also cited Fife v. Facebook, a case that found that disaffirmance of a contract by a minor rescinds the entire contract, rendering it void. The court also noted that the California Family Code does specifically exclude certain types of contracts from disaffirmance, such as contracts for necessaries for the minor or the minor's family, and ruled that Lopez's contract with Kmart is not one of those types of contracts. DECISION: Lopez had the right to disaffirm the agreement and did so in a timely manner, rendering the agreement void. Kmart's movement to compel arbitration was denied and Lopez was free to pursue his class action claim in court. SIGNIFICANCE: This case demonstrates the power a minor has to disaffirm any contracts he or she enters into and may serve as a caution to those entering into contracts with minors. CRITICAL THINKING Kmart's attorneys argued unsuccessfully that by allowing the minor to disaffirm the employment, the court was discouraging employers from hiring minors in the future. Do you think the court should have given more weight to this argument? ETHICAL DECISION MAKING What values were in conflict when the court made this decision? GLOBAL Context Flag Illustrations/Alamy Stock Photo Capacity of a Minor in Iran United States law allows minors to void

certain contracts. The mentality behind this law is that individuals below a certain age cannot be entirely accountable for their decision. The age of majority in Iran is 15 for males and 9 for females. Iranian law distinguishes between two classes of minors, “discriminate” and “nondiscriminate,” each with different capacities to contract. Discriminate minors are those old enough to understand their pecuniary interests to some extent and can distinguish between right and wrong but cannot carry out their financial affairs independently. Contracts made by “discriminate” minors are not void but do not become valid and enforceable unless later validated by the minor’s parent or guardian. Nondiscriminate minors are those too young to properly understand their own interests, and any contract they enter into is immediately null and void. Whether a minor is discriminate or nondiscriminate is determined by a magistrate based on the child’s perceived competence. Typically, a minor is considered discriminate around the age of six or seven. Source: Parviz Bagheri et al., “Parties’ legal capacity in electronic commerce transactions,” 44 Eur. J. Law Econ. 503 (2017). The obligations of the minor on disaffirmance vary from state to state. Traditionally, most states simply required the minor to notify the competent party of the intent to disaffirm and return to the competent party any consideration received under the contract that was still under the minor’s control, regardless of the condition of the consideration. If the consideration has been destroyed or damaged, the minor returns whatever is left of it, and the other party has no recourse against the minor under most circumstances. For instance, if William, a minor, purchased a stereo receiver from Sound Systems, Inc., under a six-month contract and dropped it a week after he took it home, he could return it to the store in its broken condition and tell the owner that he wished to rescind the contract. He would be entitled to the return of his down payment and would owe no further obligations to the store. Page 240 Such a rule makes sense if you view minors as innocents in need of protection from competent adults who would otherwise take advantage of minors. However, the rule does not encourage competent parties to enter into contracts with minors, and some observers argue that it allows a knowledgeable and unethical minor to take advantage of a competent party. Consequently, a number of states have modified the duty of the minor on disaffirmance, holding that the minor has a duty of restitution that requires them to place the competent party back in the position that party was in at the time the contract was made. Thus, continuing with the stereo receiver example, in some states, William would have a duty of restoration that would require him to compensate the store owner for the difference between the value of the receiver in the condition it

was in when given to William and its value in the condition it was in when returned. The disaffirmance must occur before or within a reasonable time of the minor reaching the age of majority. What constitutes a reasonable time is determined on a case-by-case basis. Exceptions to the Minor’s Right to Disaffirm the Contract The minor’s right to disaffirm is designed to protect the minor from competent parties that might otherwise take advantage of the minor. But there are certain situations in which, primarily for public policy reasons, either the courts or state legislatures have determined that the minor should not have the right to disaffirm the contract. As a general rule, most states will not allow a minor to disaffirm contracts for life insurance, health insurance, psychological counseling, the performance of duties related to stock and bond transfers and bank accounts, education loan contracts, child support contracts, marriage contracts, and contracts to enlist in the armed services. Most of these exceptions apply in most, but not all, states. Another contractual issue on which the states disagree is the minor’s misrepresentation of his or her age. Although the majority rule is that misrepresentation does not affect a minor’s right to disaffirm a contract, some states hold that when a minor who appears to be of the age of majority misrepresents their age and a competent party relies on that misrepresentation in good faith, the minor gives up the right to disaffirm the agreement. One justification for this rule is that any minor who intends to misrepresent his or her age does not need the protection that disaffirmance is designed to provide. Other states have found a compromise between the two extreme positions either by requiring the minor to restore the competent party to that party’s precontract position before allowing the disaffirmance or by allowing the minor to disaffirm but then giving the competent party the right to sue the minor in tort and recover damages for fraud. Of course, as the previous paragraphs indicate, the laws created to protect minors from being victimized by competent adults do not necessarily protect competent adults from being taken advantage of by knowledgeable and unethical minors. Thus, individuals operating or working in businesses that are subject to laws requiring their customers to be the age of majority or older must familiarize themselves with the laws pertaining to minors because, often, the responsibility of making sure that a business is dealing with people who are of legal age falls on the employees and the owner. However, because some minors use false identification or misrepresent themselves as adults, it is sometimes difficult for business owners and employees to recognize which customers are truly of age. Page 241 For example, as CEO of Girls Gone Wild (GGW), Joe Francis runs a business that requires him to be familiar with the laws surrounding minors. In fact, Francis has said that GGW has very specific

procedures in place to prevent filming underage girls and even teaches its camera crew ways to ensure that the girls the crew is selecting to appear in GGW spring break videos are of age. During the selection procedure, the GGW camera crew is required to check the IDs of girls wanting to be filmed, obtain signed written release forms in which the girls give their consent to be filmed, and videotape the girls' IDs as well as the actual process of signing the release forms. Despite his company's strict policies, Francis found himself in the middle of a heated legal battle in 2003 when seven girls claimed that they were underage when the GGW camera crew filmed them on vacation in Panama City, Florida. Francis fought back, saying that the girls misrepresented themselves, knowingly sought out the GGW crew, and wanted to exploit the company to obtain a monetary settlement. After four years of court proceedings and intense media coverage, Francis reached an undisclosed settlement with the women, who reportedly wanted a total of $70 million. Liability of Minors for Necessaries Contracts for necessaries are sometimes considered an exception to the rule that minors can disaffirm their contracts. Technically, a minor can disaffirm contracts for necessaries; however, the minor will be held liable for the reasonable value of the necessary. The purpose of this limitation is to ensure that minors can obtain the basic necessities of life when their parents will not provide them. A contract for a necessary is a contract that supplies the minor with the basic necessities of life, generally thought of as food, clothing, shelter, and basic medical services. It is sometimes difficult, however, to determine whether something is in fact a necessary. Some courts define a necessary as what is needed for the minor to maintain his or her standard of living and financial and social status, but this can lead to a problem when an item that may be considered a necessary for a child of upper-income parents might be considered a luxury to a child of lower-income parents. Whether an item is considered a necessary is also related to whether the minor's parents are willing to provide the item in question for the minor. For example, in a recent case, a minor chose to live independently, but her parents kept her bedroom open for her and were willing to have her return home any time. When she chose to return home after having fulfilled only two months of a year-long lease, the court found that the lease for the apartment was not a necessary because her parents had always been willing to provide a home for her.3 LO 11-2 Explain how a contract created when one is a minor may be ratified after one is no longer a minor. Ratification Once a person reaches the age of majority, they may ratify, or legally affirm, contracts made as a minor. Once ratified, the contract is no longer voidable. Ratification may be either express or implied. An express ratification occurs when, after reaching the age of

majority, the person states, either orally or in writing, that they intend to be bound by the contract entered into as a minor. For example, when she is 17, Marcy enters into an agreement to purchase an automobile from Sam for 10 monthly payments of $1,000. After making the fifth payment, Marcy turns 18 and decides to move out of state. She emails Sam and tells him not to worry because, even though she is moving, she still intends to make her monthly payments to purchase the car. She has expressly ratified the contract. An implied ratification occurs when the former minor takes some action after reaching the age of majority that is consistent with an intent to ratify the contract. Going back to the previous example, if, the day after she turns 18, Marcy enters into an agreement with Joe to sell him the car in six months, that action is obviously consistent with an intent to finish purchasing the car, so she has impliedly ratified the contract. Most courts find that continuing to act in accordance with the contract, such as continuing to make regular payments under a contract after reaching the age of majority, constitutes ratification. For example, if Marcy continued using the car and making payments on it for several months after reaching the age of majority, the courts would probably find that she had ratified the contract. Page 242 Parents' Liability for Their Children's Contracts, Necessaries, and Torts As a general rule, parents are not liable for the contracts entered into by their minor children. Because of this rule, merchants are often reluctant to enter into contracts with minors unless some competent person is willing to agree to cosign the contract. In that way, the competent person will be legally bound to perform the obligations undertaken by the minor if the minor no longer wishes to live up to the terms of the contract. Parents do, however, have a legal duty to provide their children with the basic necessities of life, such as food, clothing, and shelter. Thus, they may be held liable in some states for the reasonable value of necessaries for which their children enter into contracts. In most states, parents are not liable for the torts of their minor children; minors are liable for their own personal torts. In many states, however, parents may be liable when a child causes harm because the parent failed to supervise the child properly, thereby subjecting others to an unreasonable risk of harm from the child. Mentally Incapacitated Persons Persons suffering from a mental illness or deficiency may have full, limited, or no legal capacity to enter into a binding contract, depending on the nature and extent of their mental deficiency. If a person suffers from mental problems yet still understands the nature of the contract and the obligations imposed by it, the person may enter into a binding, legal agreement. Suppose, for example, that Gina suffers from the delusion that she is a rock star. When an encyclopedia salesperson comes to her door, she buys a set of

encyclopedias from him because she believes that it is important for her to be knowledgeable to set a good example for her fans. As long as she understands that she is binding herself through a contract to make monthly payments for two years to pay for the encyclopedias, she is bound to the contract. If, after making a year of payments, she no longer suffers from her delusions and wishes to disaffirm the contract, she will not be able to do so because her delusions did not affect her understanding of what she was legally agreeing to do. However, a person suffering from a mental illness or deficiency that prevents understanding of the nature and obligations of the transaction being entered into has only limited capacity to enter into a contract. If, in the preceding scenario, Gina's delusions prevented her from understanding that she was signing a contract, and she thought she was giving the salesperson her autograph when she signed the contract, the contract is voidable. She may disaffirm it at any time until a reasonable time after she no longer suffers from the mental deficiency. Once the mental deficiency has been removed, she may also choose to ratify the contract. As with contracts of minors, a contract of a person suffering from a mental deficiency that is for necessaries can be enforced for the reasonable value of the necessary. A person with mental deficiencies that result in an adjudication of insanity and an appointment of a guardian has no capacity to enter into contracts and any contract attempted is void. Guardians may be appointed not only for those who are adjudicated insane but also for those who are adjudicated habitual drunkards and those whose judgment has been impaired because of a condition such as Alzheimer's. In any case, although the person for whom the guardian has been appointed no longer has the legal capacity to enter into contracts, the guardian has the legal capacity to enter into contracts on that person's behalf. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Let's say in the Case Opener that it was not a child making a purchase but a mentally disabled person named Chloe. Let's say that Chloe was convinced that she owned a dog, even though she didn't, and ordered $1,000 worth of dog food. Which kind of legal capacity would Chloe have? Could she then avoid her contract? What if Chloe had been adjudicated insane and committed to a mental institution but was staying with her sister on a weekend visitation pass when she made the purchase? Page 243 Intoxicated Persons For purposes of determining capacity, intoxicated persons include those under the influence of alcohol or drugs. There is some variation among states in the treatment of the capacity of intoxicated persons to enter into contracts. As a general rule, most states follow the Restatement of Contracts, Section 16, which provides that contracts of an intoxicated person are voidable by the intoxicated person if

the other party had reason to know that because of the intoxicated person's condition, that person was unable to understand the nature and consequences of the transaction or was unable to act in a reasonable manner in relation to the transaction. If the intoxication merely causes someone to exercise poor judgment, the person's capacity to enter into a legally binding contract is not affected. Likewise, if one party has no way of knowing that the other was intoxicated at the time the agreement was made, and the agreement is a fair one, it will be upheld by most courts. For example, Lisa emails Rob and offers to buy his antique car from him for $8,000. Rob has just broken up with his girlfriend and has been drinking nonstop all day. He gets the email message and immediately responds in the affirmative. Lisa had no way of knowing Rob was intoxicated, so they would have a valid contract in most states. Once sober, the intoxicant has the ability either to ratify or disaffirm the contract. Because public policy does not favor intoxication, the courts tend to be unsympathetic to intoxicants and will fairly liberally interpret behavior that seems like ratification as ratifying the contract. If Jim became intoxicated at a bar one evening, and Randi took advantage of the situation by getting him to sign a contract to sell her his 2004 SUV for $8,000, any act Jim takes consistent with ratification after becoming sober will result in a binding contract. If Randi appears at his house the next morning with the cash, shows him the contract drafted on a napkin that he signed, and asks for the keys and the title, then by giving her the keys and saying, "I knew I shouldn't have drunk that much," Jim has entered into a binding contract. If the contract is disaffirmed on the basis of intoxication, each party to the contract must return the other to the condition they were in at the time the contract was entered into. Also, as with contracts of persons who have limited capacity, a contract of an intoxicated person for necessaries will be enforced for the reasonable value of the necessaries. Exhibit 11-1The Three I's of Incapacity: General Rules TYPE OF INCAPACITY CONSIDERATIONS IF THE ANSWER IS YES, THE GENERAL RULE IS: Infancy Is the person under the age of majority (a minor)? The contract is voidable. Insanity Is the person suffering from mental deficiencies that prevent them from understanding their legal obligations under the contract they are entering into? The contract is voidable. Does the person's mental deficiency simply impair their judgment about the desirability of the contract but not prohibit them from understanding their obligations under it? The contract is valid. Is the person adjudicated insane? The contract is void. Intoxication Is the sober party aware that the intoxicated person is so impaired that he is unable to understand their legal obligations under the contract they are entering into? The contract is voidable. Is the intoxication

such that it impairs only the intoxicated person’s judgment but not their understanding of their contractual obligations? The contract is valid. Has the intoxicated person been adjudicated a habitual drunkard? The contract is void.

Legality LO 11-3 List the conditions under which a contract is unenforceable by law. To be enforceable, a contract must have a legal exchange as its subject and must be able to be performed legally. In the event of a contract with an illegal subject, it is the agreement or the bargain that is illegal, not the contract. By definition, contracts are legal. That is why when a contract is overturned due to being contrary to law, the contract is frequently declared void, as if it never existed, as opposed to being declared illegal. It is important to recognize, however, that contracts can be determined illegal even if they are not against a specific statute. When contracts are against generally accepted public policy, these agreements are determined to be unenforceable, and not void. No remedy is available for unenforceable agreements. Contracts that Violate State or Federal Statutes As previously stated, certain agreements are illegal because either the subject or the performance of the agreement violates a state or federal statute. Given the various state and federal statutes, there are a large number of possible ways in which contracts can violate a statute. Some of the more common ways are discussed below. Agreements to Commit a Crime or Tort Contracts cannot be for an illegal subject or be carried out by illegal means. Therefore, any agreement to commit a crime or tort is illegal and unenforceable. However, if a legal contract is formed and then the subject of the contract becomes illegal under a new statute, the contract is considered discharged by law. For example, Jim agrees to work for Heather for one year as a poker dealer at her casino. After Jim and Heather enter into this employment agreement, the state government passes a law saying that poker may no longer be offered in casinos in the state. Because it would now be illegal for Jim to work as a dealer, the contract is discharged by law. Licensing Statutes All 50 states have statutes requiring people who work in certain professions to obtain a license before practicing their craft. For example, doctors of all varieties, plumbers, cosmetologists, lawyers, electricians, teachers, and stockbrokers are all required to obtain a license before practicing. Although this list of professions is far from exhaustive, it demonstrates how widespread the licensing requirement can be in various states. When licensing is required by law, people in certain fields must obtain a license before they can legally enter into an agreement to perform the restricted services. Frequently, such

licenses can be obtained only after extensive schooling or training. The requirement of schooling and licensing demonstrates the concern society places on proper performance of duties in the designated professions. In addition to indicating concern with proper performance, licensing statutes have two main purposes. The first is to give the government an avenue by which to regulate the specific industries. By requiring professionals to obtain a license, the government has some say over who can perform which jobs as well as how many people can perform these jobs. The second main purpose of licensing statutes is more closely related to the public interest. This second purpose is to protect the public's health, safety, and welfare. By imposing legal standards on a profession, the government is attempting to prevent people from being harmed due to substandard work. For example, surgery is a delicate, complicated process. It is not in the public's best interest to allow an unqualified person to perform surgery. Therefore, to limit the number of people who might be harmed during surgery, the government steps in and requires surgeons, even after extensive schooling, to obtain a license. In most states, the purpose of the licensing statute is determinative of whether a contract signed by an unlicensed professional will be enforced or not. If the purpose of the licensing statute is to regulate the number of professionals in the state or generate revenue for the state through licensing fees, a contract with an unlicensed person will still be enforced. Page 245 Conversely, if the licensing statute is intended to protect the public's health, safety, or welfare, the agreement is typically deemed illegal and unenforceable. Licensing statutes can only protect the public if people without the necessary licenses are not allowed to practice these restricted professions. Returning to the example of surgeons, the public is made safer when the government allows only licensed professionals to perform surgery. Therefore, people cannot enter into a contract for professional service with unlicensed professionals when the law requires a license and the statute is intended to protect the public. Case 11-2 illustrates how failure to obtain a license can preclude a party from suing to enforce a contract. CASE 11-2 BAJA PROPERTIES, LLC v. MATTERA 812 SE 2d 358 (2018) FACTS: In September 2013, Ugo Mattera entered into a written construction contract with Baja Properties, LLC. Stephen Chad Golden, the sole owner of Baja Properties, signed the contract and addendums on Baja Properties' behalf. Pursuant to the contract, Baja Properties agreed to build a house for Ugo Mattera on land he and Kellie Mattera owned. Baja Properties completed some of the construction, but disputes developed and Ugo Mattera terminated the contract before the house was completed. Stephen Golden did not have a Georgia builder's or contractor's license when the parties

entered into the contract or when the work was performed. The Matteras moved for summary judgment on Baja Properties' claims against them, asserting that OCGA § 43-41-17 (b) bars an unlicensed contractor from enforcing in law or equity a contract for the performance of work for which a license is required. The trial court granted the Matteras' motion for summary judgment on all of Baja Properties' claims, finding that the claims were barred by OCGA § 43-41-17 (b). Baja Properties appealed. ISSUE: Is Baja Properties' right to sue barred by statute? REASONING: OCGA § 43-41-17 (a) provides, in pertinent part, that no person shall have the right to engage in the business of residential or general contracting without a current valid contractor license. OCGA § 43-41-17 (b) provides, in pertinent part, that a contract for the performance of work between an owner and a contractor without a valid contractor license shall be unenforceable by the unlicensed contractor. It is undisputed that Baja Properties and the Goldens did not have Georgia contractor's licenses when the construction contract was executed and when the work was performed pursuant to the contract. The construction contract clearly identifies Baja Properties as the "Contractor" and Ugo Mattera as the "Owner" of the land on which the construction was to be completed. Thus, under OCGA § 42-41-17 (b), the construction contract is not enforceable by Baja Properties in law or in equity unless an exemption applies. Baja Properties argued that it is exempted from OCGA § 43-41-17 (b) by another provision that allows an owner performing construction on his own property to act without a license. Baja Properties posits that because this provision permits a property owner to act as his own contractor and to use unlicensed contractors, the construction contract at the center of this dispute is "otherwise exempted" from the unenforceability provision of subsection (b). The court held, however, that this provision does not provide that an unlicensed contractor is exempt from the rule that prohibits an unlicensed contractor from enforcing an agreement for the performance of work for which a license is required. The rule was clearly meant to protect owners doing the contracting work themselves as opposed to contractors operating without a license. DECISION AND REMEDY: The motion for summary judgment denying Baja Properties' counterclaim is affirmed with respect to Baja's claim for compensation for work done under the contract. SIGNIFICANCE OF THE CASE: This case illustrates the impact that not having a license can have on the enforceability of a contract. CRITICAL THINKING When a judge or judicial panel makes a decision, it must do so on the basis of the information available to it. What is an illustration of a fact that, were it true, might have led to a different outcome in this case? ETHICAL DECISION MAKING The statute spelling out the need for a contractor's license to

perform construction work had an exemption allowing a person to perform construction on their own property without such a license. What stakeholders are being especially advantaged and disadvantaged by the exemption? While most states use the purpose of the licensing statute as the primary determiner of whether to enforce a contract entered into by an unlicensed professional, a few states are more restrictive and will not enforce any contracts entered by an unlicensed party to be enforced. Therefore, it is prudent to check the state law in any situation in which the enforcement of a contract by an unlicensed party. Nonetheless, because the professional is in violation of the law, they are usually required to pay a fine for working without the necessary license. Page 246 While most states use the purpose of the licensing statute as the primary determiner whether to enforce a contract entered into by an unlicensed professional, a few states are more restrictive and will not enforce any contracts entered by an unlicensed party to be enforced. Therefore, it is prudent to check the state law in any situation in which the enforcement of a contract by an unlicensed party may be an issue. Usury Almost as widespread as licensing statutes, statutes prohibiting usury exist in nearly every state. Usury occurs when a party gives a loan at an interest rate exceeding the legal maximum. The legal maximum interest rate varies from state to state, but it is easy to determine the rate in any given state. Although usury statutes act as a ceiling in terms of setting a maximum possible rate, there are a few legal exceptions whereby loans may exceed the predetermined maximum. One exception relates to corporate loans. Most states with usury statutes allow corporations to lend and borrow at rates exceeding the maximum. The rationale behind the corporation exception is that if a business needs money to expand and is willing to pay the higher interest rate, the corporation should be afforded the opportunity to borrow. The converse is that if a corporation is willing to borrow at a high interest rate, parties should be allowed to lend at that rate for corporations only. The intent is to facilitate business transactions to keep the economy in a healthy state. Another exception to usury statutes applies to smaller loans. Many states allow parties to make small loans at rates above the maximum to parties that cannot obtain a needed loan at the statutory maximum. The belief is that if people need money and the statutory maximum is not inducing people to lend, certain parties will make the necessary loans at a higher rate as long as the loan is small, which is defined however the state chooses to define it. This exception is the principle that allows cash advancement institutions to operate. If there is no exception that allows a usurious loan, the legal outcome varies by state. A minority of states declare all usurious loans void, which means the lending party is not entitled to

recover either the interest or the principal. A larger number of states allows lenders to recover the principal amount they loaned, but these parties cannot collect any interest on the loan. In addition, a final group of states allows lenders to recover the principal as well as an amount of interest up to, but not exceeding, the statutory maximum. In essence, these states allow the lenders to recover all but the excess interest, as if the loan were given at the statutory maximum rate. Gambling As with licensing statutes, all states engage in at least some regulation of gambling. In this chapter, the term gambling refers to agreements in which parties pay consideration (money placed during bets) for the chance, or opportunity, to obtain an amount of money or property. Although gambling is still illegal in the vast majority of states, many states allow casino gambling. The states most notable for casino gambling are Nevada, New Jersey, and Louisiana. Some states allow certain other types of gambling, either intentionally or through legal loopholes. For example, given California's definition of gambling, betting on draw poker is legal. Some states make other exceptions, such as for horse tracks, casinos located on Native American reservations, or legal state-run lotteries. E-Commerce and the Law Observing Sabbath Days Online Sabbath days stem from the religious traditions that were so widespread in America's early days. Among the religions that still observe Sabbath days today is Judaism, which has very strict laws in relation to refraining from conducting business on the Sabbath. This prohibition even extends to the online realm. Not only are those of the Jewish faith told to abstain from conducting online transactions on the day of the Sabbath, but they are also prohibited from making transactions online even if the individual in question has no awareness of it. For example, if an individual schedules to pay for an item when it ships, and the item happens to be shipped on the day of the Sabbath, that individual is considered to have broken Sabbath law. Laws against conducting certain types of business are still active even today, though they may not be rigidly enforced. Source: Rabbi Harvey Belovski, "Must Your Online Shop Shut On Shabbat?" Belogski.blogspot.com, March 6, 2008. Page 247 Sabbath Laws A large number of states still have what are known as Sabbath, Sunday, or blue laws on the books. Sabbath laws limit the types of business activities in which parties can legally engage on Sundays. In most states with Sabbath law restrictions, these laws date back to colonial times. In fact, the term blue law is a reference to the blue paper on which New Haven, Connecticut, printed its Sabbath laws in 1781. New Haven's 1781 law prohibited shops from being open and prohibited all work on the "Lord's day" (Sunday). The activities restricted today by Sabbath laws vary from state to state. Most Sabbath laws pertain to the sale of alcoholic

beverages. These laws tend to prohibit the sale of all alcohol or at least specific types either all day or at restricted times on Sundays. Some Sabbath laws go as far as to make it illegal to enter into any contractual relationship on a Sunday. However, an executed, or fully performed, contract created on a Sunday cannot be rescinded. There are exceptions to Sabbath laws. Most states with Sabbath laws allow the performance of charity work on Sundays. In addition, Sabbath laws do not typically apply to contracts involving procurement of necessities, typically defined as prescription medication, food, or anything else related to health or survival. Regardless of how widespread Sabbath laws are, the vast majority of states do not enforce all, or at least some, of their Sabbath laws. In fact, some Sabbath laws have in the past been deemed unconstitutional according to the First Amendment. Nevertheless, if Sabbath laws are on the books, despite convention to the contrary, they can be applied, and some states do apply such laws. As a businessperson, you should always find out whether Sabbath laws exist and, if they do, whether authorities enforce these laws. Agreements that Violate Public Policy Unlike agreements that are precluded by statute, some types of agreements are not illegal per se, because they are not in violation of any statute or legal code, but are unenforceable because courts have deemed them to be against commonly held public policy. Public policy involves both the government's concern for its citizens and the beliefs people hold regarding the proper subject of business transactions. The focus is on what is in society's best interest. Contracts in Restraint of Trade It is a widely held belief in economics, as well as in America in general, that competition drives down prices, which is good for consumers. Accordingly, agreements that restrain trade are viewed as being harmful to consumers and thus against public policy. These restraints on trade are also known as anticompetitive agreements. Not only are anticompetitive agreements against public policy, they also frequently violate antitrust laws. There is an exception that allows specific types of restraints on trade. When a restraint on trade is reasonable, as determined by the courts, and the restraint is part of a subordinate, or ancillary, clause, the restraint is typically allowed. Such restraints are known as covenants not to compete, or restrictive covenants. Covenants not to compete tend to come in two varieties. The first involves noncompetition in the sale of an ongoing business, and the second involves noncompetition in employment, both of which are discussed below. Page 248 The first category of permissible restraints on trade is covenants not to compete that involve the sale of an ongoing business. Ongoing refers to the status of the business being sold: The business is still running and will still run on its own; it is not being merged and is not closing down. The public policy argument in favor of

supporting restrictions with the sale of a business involves the fairness of the sale. Let us examine a hypothetical situation to see why this restraint on trade is allowed. Suppose you purchase a jewelry store from Ann Smith. Ann is a well-respected member of the community, and her business has been around for many years. The people in the community know the store, and they trust Ann to provide fair exchanges. As a well-informed businessperson, you know about Ann's reputation. In fact, her good reputation made the purchase more appealing. Now suppose Ann turns around and opens another jewelry store a block away one month later. Ann's loyal customers are likely to go to her new store because they still trust her. In the meantime, Ann's good name is no longer associated with your store, and your business suffers accordingly. You entered into the sales agreement thinking you would benefit from Ann's good name, but in the end you overpaid for a business that lacks the benefit of Ann's name because Ann took her name with her when she went into competition with your store. In the interest of self-proclaimed fairness, courts are willing to impose restrictions preventing Ann, or others in her position, from going into immediate competition with you or others in your position. Public policy requests fairness in business transactions, and this fairness does not occur when people profit from a business transaction and then start a new business that destroys the business they just sold. Consequently, the restraints to trade being discussed with the sale of an ongoing business involve the seller's ability to open up another business within a certain geographic location within a designated time period. As previously mentioned, to be enforceable, a covenant not to compete needs to be in a subordinate clause in the contract. If the covenant not to compete is part of the main agreement, and therefore not subordinate, the agreement is typically considered unenforceable and void because it goes against public policy by providing unreasonable restraints to trade. The unreasonableness arises because when the covenant is an integral part of the contract, it cannot be objected to. In contrast, when the covenant is subordinate, the specific noncompetition clause can be removed and the agreement can go forward as planned. The second category of permissible restraints on trade is covenants not to compete that involve employment contracts. The covenants in employment contracts are similar to those in sales contracts. However, with employment, employees are agreeing that if they leave they will not compete with their boss for a designated period of time within a designated geographic area. Covenants not to compete in employment contracts are legal in most states. However, to be legal, the covenant needs to protect a legitimate business interest. Furthermore, the covenant needs to be for a reasonable period of time and geographic area so that it does not

unlawfully impinge on the employee’s right to earn a living. The agreement must not be for a longer period of time or larger geographic region than is necessary to protect the employer’s legitimate business interest. Given the variations from state to state in other areas of the law, it should come as no surprise that the enforceability of covenants not to compete also varies from state to state. For example, California does not allow any covenants not to compete. On a different note, Texas requires the employee to gain a specific benefit from a contract, beyond employment, before its courts will enforce a covenant not to compete. The employee must be given, or gain, something even if the covenant not to compete is for a reasonable period of time and geographic region. LO 11-4 Describe instances in which unfairness affects a contract’s enforceability. Unconscionable Contracts or Clauses When courts are asked to review contracts, fairness is not usually high on the courts’ lists of things for which to look. Instead, courts typically assume that the contracting parties are intelligent, responsible adults. The belief is, barring proof of coercion, that parties enter into contracts because they want to do so. Nevertheless, there are times when agreements are so one-sided, or heavy-handed against one party, that the courts will not make the harmed, innocent person fulfill his or her contractual duties. These heavily one-sided agreements are known as unconscionable agreements. The term unconscionable refers to the fact that the agreement in question is so unfair that it is void of conscience. Page 249 Rules against unconscionable contracts exist in both the Restatement (Second) of Contracts and the Uniform Commercial Code. However, before the Restatement and the UCC existed, the common law would not enforce contracts the courts deemed too unfair, or unconscionable. Now, UCC Section 2-302 states: (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result; (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable, the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination. Every state, with the exceptions of California and Louisiana, has incorporated the preceding UCC section into its state’s UCC. Section 208 of the Restatement also incorporates this section from the UCC. There are two main types of unconscionable agreements, procedural and substantive. Procedural unconscionability relates to conditions that would impair one party’s understanding of a contract and to the integration of terms into a

contract. Regarding impaired understanding of contractual terms, the factors can be anything from tiny, hard-to-read print on the back of an agreement to excessive use of legalese (unnecessarily technical legal language) or even the inability of a person to read over a contract fully and ask any questions before he or she was required to sign. Most frequently, procedural unconscionability arises when one party presents the other with an adhesion contract. An adhesion contract is a contract created by a party to an agreement that is presented to the other party on a take-it-or-leave-it basis. That is, the contract is presented as complete and as the only chance the presented party (known as the adhering party) will have to enter into the agreement. Although adhesion contracts are themselves legal, the presence of one does raise some potential problem indicators for courts. Given that adhesion contracts usually do not allow for debate regarding the agreement, courts tend to examine adhesion contracts to see whether they can determine how voluntary the agreement really was. Conversely, substantive unconscionability involves overly harsh or lopsided substance in an agreement. That is, if an agreement is terribly one-sided, it is probably invalid on the basis of substantive notions of fairness and fair dealing. Courts would find the following, for example, to be substantively unconscionable: high differences between cost and price in a sales agreement; agreements in which one party gains vastly more than the other; agreements in which one party is prevented from having any sort of equal benefit; agreements in which one party has little to no legal recourse, according to the agreement; and portions of an agreement that are completely unrelated to anything having to do with either party’s business risk. Exculpatory Clauses An exculpatory clause is a statement releasing one of the parties to an agreement from all liability, regardless of who is at fault or what the injury suffered is. Because tort law attempts to return the wronged party to the state they were in before the wrong occurred, anything preventing this corrective mechanism is against public policy. It does not benefit society to allow some parties to get away with not having to pay for wrongs they commit simply because they state they will not be liable in various contracts. In fact, the patently unfair nature of an exculpatory clause is closely tied to the idea of unconscionable contracts. Exculpatory clauses frequently show up in rental agreements for commercial or residential property. These clauses are often found to be against public policy. The reasoning is that sometimes people are injured while on property they are renting from another, and sometimes the injuries are due to the carelessness, negligence, or other wrongdoings of the owner. Once again, it does not serve the public’s interest to allow landlords, especially when it comes to residential property, simply to

disavow all liabilities in advance. If they were allowed to do so, landlords would not be required to fix problems in their rental units, including potentially lethal problems such as faulty electric wiring or lead-based paint. Page 250 A basic test to determine whether an exculpatory clause is unenforceable is to see whether the enforcing party engages in a business directly related to the public interest. Examples of such businesses include banks, transportation providers, and public utilities. Courts believe it is against the public interest to release businesses engaging in work in the public's interest from accountability to the public they are serving. Another concern with large businesses that are serving the public interest is the unfair bargaining power they can possess in negotiating a contract. Given the power these businesses have, they could simply demand that all customers must accept the exculpatory clause, thus escaping all possible liability. Although the idea of these businesses not being liable is bad, what is worse is that there would be no punitive financial motive for them to conduct their business operations carefully, or so the argument goes. As a result, the potential for increased accidents would be large. Obviously, it is not in the public's interest to have unsafe businesses that are not accountable to the public. Thus, these businesses cannot enforce exculpatory clauses. It is often difficult to know when a court is going to find that an exculpatory clause exists. Case 11-3 details a situation in which the court found that an illegal exculpatory clause did not exist. CASE 11-3 RILEY AND v. STONE GATE Court of Appeals of Washington, Division 2 395 P.3d 1059 (2017) FACTS: Larry Riley formed a rental agreement for a self-storage unit with Iron Gate Self Storage in December 2003. The agreement stated that a maximum of $5,000 of personal property could be stored in the unit and that Iron Gate could only be held liable for up to $5,000. Despite that known limit on liability, at times Riley had more than $1.5 million worth of property stored in his unit. Over the course of the lease, Riley fell behind on payments. From May 2010 to July 2010, Iron Gate sent Riley three past-due notices. In July, Iron Gate sent Riley a notice of auction and the auction occurred seven days later. A bidder paid $2,000 for the contents of Riley's storage unit. Although Iron Gate believed it acted lawfully, Washington state law requires a fourteen day waiting period after the notice before the auction can be held. Two days after the auction, Riley sent Iron Gate a letter asserting that the notice was invalid and the auction should not have occurred. Iron Gate recovered many of the sold auction items by repurchasing them and held them in a storage unit free of charge until Riley retrieved them. However, Riley filed a complaint claiming Iron Gate had violated the Storage Act and the CPA and alleging $1.5 million in damages. Iron Gate believed its liability should be limited to the $5,000 in

their limitation of liability clause. ISSUE: Was clause limiting the liability of Iron Gate to $5,000 an illegal exculpatory clause? REASONING: To determine whether Iron Gate's exculpatory clause violated public policy, the court considered six criteria: (1) whether the agreement concerns a situation generally suitable for public regulation; (2) whether Iron Gate performs a service that is of great importance or necessity to the public; (3) whether Iron Gate holds itself out as willing to perform its services for any member of the public who seeks it; (4) whether Iron Gate possesses a decisive advantage in bargaining power over a member of the public who seeks its services; (5) in exercising its superior bargaining power, Iron Gate effectively forces people seeking its services into agreeing to the exculpatory clause; and (6) whether the property of people seeking such services must be placed under control of Iron Gate. The court compared the facts of the case to each criterion. First, Iron Gate is in the self-storage industry, which is in fact a highly regulated industry. Iron Gate is subject to numerous requirements contained within the Storage Act. Second, Iron Gate's self-storage services are not an essential public service. Third, Iron Gate advertises itself to the general public as willing to rent units to any person who seeks it. Fourth, Iron Gate does not have a advantage in bargaining power because Riley had the freedom to take his business elsewhere if he disagreed with the agreement's provisions. Fifth, Iron Gate did not force Riley into the exculpatory clause. Iron Gate provided Riley with an opportunity to purchase insurance that would cover the entire value of his property, but he chose not to do so. Finally, Riley had exclusive control over his unit and the property within. Riley used his own lock on the unit and Iron Gate was only allowed to enter with written notice, in case of emergency, or if Riley defaulted. In light of the facts, the court concluded that Iron Gate's exculpatory clause did not violate public policy. Per the signed agreement, Iron Gate reasonably believed that the contents of Riley's unit did not exceed $5,000. Thus, Iron Gate is not liable for the $1.5 million in value that the contents of the unit allegedly had. DECISION AND REMEDY: The lower court's finding that the clause did not violate public policy and therefore was not illegal was affirmed in favor of the defendant, and therefore its liability was limited to $5,000. SIGNIFICANCE OF THE CASE: In this case, the court clearly lays out the requirements for an exculpatory clause to violate public policy and explains how the clause in question does not meet these requirements. Thus, this case serves as an excellent illustration of when such a clause is and is not binding. CRITICAL THINKING Consider the sixth item in the test applied by Washington state courts. In this case, the court asserted Riley had exclusive control of his storage unit because he placed his own lock on the unit and "Iron Gate could

only enter the unit with written notice, in the case of an emergency, or if Riley defaulted.” Do you think the sixth item in the test could be problematic if applied to apartment renters? ETHICAL DECISION MAKING Examine the actions of each party leading up to this dispute. Who behaved in a blameworthy fashion, and who in a praiseworthy fashion? What facts from the case and what ethical theories or guidelines support your claim? Now consider each party’s stance in the legal dispute. Does either one appear more or less ethical, relative to that party’s earlier actions? Why or why not? Page 251 Although businesses closely linked to the public interest cannot enforce exculpatory clauses, not all exculpatory clauses are unlawful. To be able to enforce an exculpatory clause, the party seeking enforcement must be a private business or an individual and must not be important to the public interest. Such private businesses or individuals provide nonessential services and thus do not have the same bargaining power as the previously discussed groups, such as banks, utilities, and airlines. Given their lack of huge bargaining power, it is assumed that private businesses and individuals will enter on relatively equal terms and will voluntarily agree on or decline the final contract. Examples of private businesses that can enforce exculpatory clauses include skiing facilities such as resorts or rental places, private gyms or health clubs, any business offering skydiving or bungee jumping, and amusement parks, to name a few. Because the services provided by all these businesses, as well as others in this category, are not something related to the public interest and not something in which people must engage, these parties are allowed to deny liability if the party with which they are contracting agrees to the exculpatory clause. Just because these parties might be able to enforce an exculpatory clause, however, does not mean the clause is always automatically enforceable. The following Case Nugget looks at an interesting situation involving an exculpatory clause. CASE Nugget Can Parents Enter into Contracts on a Minor’s Behalf? Trent Woodman v. Kera LLC Supreme Court of Michigan 486 Mich. 228 (2010) Five-year-old Trent Woodman was injured on his birthday at Bounce Party, an indoor play area operated by Kera LLC. Before Trent began playing at the play area, his father signed a liability waiver including an exculpatory clause on Trent’s behalf. Mr. Woodman signed the form as the parent, and Trent’s name was printed on the form as “participant,” meaning he was the one participating in the activity for which the exculpatory clause was drafted. When Trent broke his leg after jumping off an inflatable slide, Trent’s mother, as next friend, filed suit against Kera LLC, on behalf of her son, alleging negligence, gross negligence, and violation of the Michigan Consumer Protection Act (MCPA). Kera LLC filed a motion for summary judgment,

claiming that the claims were barred by the exculpatory clause. Michigan common law prevents parents from entering their children into contracts that waive, release, or compromise a minor's claims. Because parents' authority of a minor is limited to the care and custody of the minor, any contract that a parent might enter into on his or her minor's behalf is unenforceable. The Michigan Supreme Court upheld the common law in this case by finding that the waiver that Trent's father signed was unenforceable. The court refused to change common law because it believed that the court lacked the tools to measure the risks involved in such a policy change adequately. Therefore, the better vehicle for changing the common law is through legislature. Trent's case was remanded for further proceedings. Page 252 Effect of Illegal Agreements LO 11-5 Recall the legal effect of entering into a contract for illegal purpose. Generally speaking, when an agreement is deemed illegal, courts will label the contract void. The reason most illegal agreements are void is that, in most cases, both parties are equally responsible for the illegal agreement. In the law, when both parties are equally responsible for an illegal agreement, the parties are said to be in pari delicto. When both parties are at fault, it does not make sense for the courts to attempt to salvage the agreement or reward either party. Therefore, most illegal agreements are void, meaning neither party can enforce the agreement and neither party is entitled to recovery. However, it is not always the case that both parties are at fault. If one party is not responsible for an illegal agreement, or special circumstances forgive the illegality, it makes sense sometimes to allow one party to an illegal agreement to recover various damages. The first exception to the general rule occurs when a member of a protected class is involved in an agreement that contradicts a statute intended to protect the specific class. In the event of such a contradiction, the member of the protected class is allowed to sue for performance. The reasoning is that if a statute is intended to protect a specific class, people outside the class should not be allowed to use the statute to harm those inside the class. For example, a work agreement between a truck driver and his or her employer may specify that the driver gets paid for the number of hours worked. Yet certain statutes limit the number of hours truck drivers may drive in a given time period. If the truck driver accidentally drives more than the allowable hours, the driver has technically violated a statute. However, this violation does not allow the employer to refuse to pay the driver for the extra hours. Rather, the driver may sue the employer to enforce the work agreement. The second exception to the voiding of illegal agreements occurs when there is a justifiable ignorance of facts. A justifiable ignorance of facts is one party's lack of knowledge regarding a provision of

the agreement that would make it illegal. Although ignorance of the law does not excuse illegal behavior, not knowing that the other party to a contract intended to fulfill the agreement through illegal means does function as an excuse. Page 253 When one of the parties is relatively innocent in the whole deal, the court may give back any consideration that party gave or may require an exchange for partial performance such that both parties can be returned to the positions they were in before they entered into the agreement. Conversely, if one party is completely innocent of any illegality and has completed their portion of the contract, then—depending on the reason the contract is considered illegal and depending on which state's laws are in question—the court might enforce the entire agreement. A third exception to the general rule occurs when one of the parties withdraws from an illegal agreement. The key to any recovery is that the party must have withdrawn before any illegality occurred. If this is the case and if part or full performance has occurred, the party may recover value for whatever portion has been completed. However, if the party is involved in any way in the illegal activity, the party cannot recover at all. LO 11-6 Describe the characteristics of a severable contract. Severable Contracts A severable contract, also known as a divisible contract, contains multiple parts that can each be performed separately. In addition, separate consideration is offered for each individual part. In essence, a severable contract is like numerous contracts in one. Conversely, an indivisible contract requires complete performance by both parties, even if it appears as though the contract contains multiple parts, similar to a severable contract. Used by permission of Stu Rees, Stu's Views. With respect to illegality, severable contracts have a huge advantage over indivisible contracts: If a severable contract has both legal and illegal portions, the court has the option of declaring void only those sections of the agreement that are illegal. The court can then enforce the remaining, legal portions of the contract. Indivisible contracts must be enforced or rejected in their entirety. For a court to be able to enforce parts of a severable contract, the parts that are enforced must still represent the main purpose of the original agreement. If declaring parts of a contract void substantially alters the contract, the court is not likely to enforce the remaining portions of the agreement. Courts ultimately want to facilitate business transactions and enforce the legal wishes of parties, and severable contracts enable courts to do so. And, of course, since severable agreements are subject to a court interpreting each section for legality, it is probably unwise to enter into such an agreement when the legality of some sections is questionable. Page 254 CASE OPENER WRAP-UP Apple's Questionable Contract The U.S. District Court for the Northern District of California denied

Apple’s motion to dismiss the lawsuit. The court stated that the complaint could not be dismissed because no case law was provided to prove that Apple’s Terms of Service served as a contract for all subsequent transactions. Apple then constructed a settlement with all the plaintiffs in the class-action lawsuit that had to be court-approved. First, Apple would have to immediately send notices to 23 million customers with iTunes accounts, notifying the customers of parental controls that can block extra purchases. Second, customers in the lawsuit were to receive a $5 credit for use at the iTunes store. Customers whose children spent $30 or more would be entitled to a cash refund instead of credits. Finally, Apple would pay $1.3 million in attorney fees. PRACTICAL TIPS for Business Managers Remember that people don’t always look their age, so always make sure to verify the age of anyone with whom you are entering into a contract. You do not want to find out you have entered into a contract with a minor by the minor telling you they want to disaffirm the agreement. There may be times when you need an exculpatory clause in one of your contracts. To ensure that the exculpatory agreement is enforceable, it is a good idea to make sure the clause is printed in a large font and initialed by both parties. If possible, provide options to the other party, so that the clause is clearly negotiated. When drafting a covenant not to compete in conjunction with the sale of a business, make sure that it is clearly reasonable both in terms of the length of time it is valid for and the geographic area. One way to determine reasonableness of both is to rely on your customer list, both in terms of where your customers live and how frequently they use your services. Because of the value of this information if you should sell your business, it is a good idea to maintain good customer lists because you never know when you may decide to sell.

SUMMARY Capacity Natural persons over the age of majority are presumed to have the full legal capacity to enter into binding, legal contracts. A person has only limited capacity to enter into a legally binding contract if the person is A minor. Suffering from a mental deficiency that prevents the person from understanding the nature and obligations of contracts. Intoxicated. A person has no capacity to enter into a contract if the person Has been adjudicated insane. Has been adjudicated a habitual drunkard. Has had a legal guardian appointed to enter into contracts on his or her behalf. Legality Contracts that do not have a legal object are not valid. Contracts may lack a legal object because they violate a statute or violate public policy. If the illegal portion of a contract can be severed from the legal portion, the courts may simply refuse to enforce the illegal parts and enforce the remaining legal parts.

Point/Counterpoint Should Minors Have Full Capacity to Enter into Binding Legal Contracts at the Age of 15? YES NO The infancy doctrine, which holds that minors are not developed enough to make fully rational decisions and therefore do not have the capacity to enter into contracts, is not only antiquated but makes faulty assumptions about the minds of minors of certain ages. No one is arguing that a two-year-old toddler has the capacity to make rational business decisions that are in their interests. The capacity of a 16-year-old, however, is a different story. Many developmental psychologists, including the famed Jean Piaget, have found that minors of ages fifteen and up have essentially the same rational capacity as adults and can utilize theoretical, hypothetical, and counterfactual thinking, as well as abstract logic and reasoning. While contract law does not recognize minors as fully rational beings, there are other areas of law that do. For example, many state criminal codes allow minors to be considered adults when being tried for heinous crimes. Approximately 250,000 minors are tried, sentenced, or convicted as adults every year across the United States, and until the Supreme Court effectively outlawed the practice in 2005, states could give minors the death penalty. The law is inconsistent in that it can assume that minors are rational adults when committing a crime, but not when entering into a contract. Another problem with the infancy doctrine is that it assumes that minors will necessarily be the victims of unfair contracts and therefore allows them the ability to disaffirm at will. However, this means that contracts with minors are voidable by the minor, but not void. In other words, the contracts are one-sided in that the minor can enforce them against the other party, but the other party cannot enforce them against the minor. In today’s digital marketplace, where minors are becoming increasingly involved and may even provide content or a service to an adult, the infancy doctrine gives minors an unfair advantage. In fact, it is not unheard of for the minors of this generation to use their tech savvy to prey on unsuspecting consumers. The infancy doctrine in the age of the digital marketplace creates another problem: online, it is almost impossible to truly verify with whom one is doing business. An online businessperson will never truly know whether their online client is a minor or not. This issue creates all sorts of risks for such a businessperson because they have no idea whether any digital-sales contract, for example, is voidable by the other party at any time. The infancy doctrine is founded on questionable assumptions and simply does not work in today’s world. The infancy doctrine is more important than ever in today’s marketplace. Even though many children have a technological prowess that overshadows that of many adults, children are not immune from abusive

contracts and are likely not developed enough to enter into contracts in the first place. Some arguments in favor of doing away with the infancy doctrine cite as a primary reason that some teenagers are cognitively developed enough to be able to rationalize on the same level as adults. Regardless of whether this is true, children and teenagers are more impulsive and lack the experience and foresight to make certain decisions in their favor. In other words, while minors can sometimes rationalize a situation as well as an adult, that does not necessarily mean that they will make as good a decision as an adult would. Thus, minors are more likely to brazenly enter into unfair contracts without having the foresight to think of the long-term consequences of doing so. Another common argument against the infancy doctrine is that minors can abuse their right to disaffirmance and enter into one-sided contracts in their favor. A classic example is one where a minor enters into a sales contract to purchase a car, immediately proceeds to wreck the car, disaffirms the contract, and demands a refund for the car while returning the totaled vehicle. However, many courts have instituted exceptions to the infancy doctrine for situations just like the one described. Often, if a minor reaps some kind of benefit from the contract, they cannot disaffirm the contract without returning that benefit to the other party in full. In the case of the wrecked car, the minor would not be able to disaffirm the contract without returning a car to the seller that was in the same condition in which it was purchased. Those who argue against the infancy doctrine fail to understand the balance of power between corporations and minors. Over the past few decades, minors have become a class of consumer all of their own, and the digital commerce age has brought the market to minors in ways that were inconceivable even at the time when the infancy doctrine first came about. Corporations specifically utilize the inexperience, naiveté, and rash decision-making of minors to finely target their advertisements and sell their products. Is it fair, for example, for a business to enter into a contract with a minor for a credit card with a 20 percent interest rate when that minor has not had the time or experience to develop financial literacy? Businesses target minors because they know minors do not have the same level of education or decision-making skills as adults, and thus minors require the protection that the infancy doctrine provides.

Questions & Problems Why does it matter that a contract with a minor is for a necessary? Explain the obligations of a minor who chooses to disaffirm a contract. Go back to the discussion of contracts that cannot be disaffirmed by minors and explain the policy reasons that support each of the

exceptions. Can you make an argument for any additional kinds of contracts that should not be subject to disaffirmance by minors? If all you know about a man is that his neighbors think he is crazy, you do not know whether a contract he entered into was valid, voidable, or void. Why not? What factors determine whether a covenant not to compete is legal or illegal? What is the relationship between contracts in restraint of trade and unconscionable contracts? Steven Sanchez worked as a warehouse employee for Gruma Corporation. In December 2016, Sanchez was presented an arbitration agreement during a meeting with George Tate, the human resources manager for Gruma. According to Sanchez, Tate told him and other workers to sign the agreement and that “whoever did not sign [the agreement] could not have a job.” Sanchez alleges that he was not told that he could opt out of the agreement and that he would have done so if he knew. Sanchez further alleges that he was pressured to sign the agreement on the spot without time to read it, which is a claim that Tate disputed. Sanchez was later fired from Gruma in August 2017. Following his termination, Sanchez filed suit against Gruma, alleging claims of unpaid wages, disability discrimination, and wrongful termination, among other claims. Gruma sought to compel arbitration. Sanchez claimed that Gruma was barred from compelling arbitration because the arbitration agreement was unconscionable. What are the two types of unconscionability a court considers when reviewing an allegedly unconscionable contract? Do you think the court agreed with Sanchez that the agreement was unconscionable? Source: Sanchez v. Gruma Corporation, Dist. Court, ND California 2019. Valve Corporation makes and distributes its own games as well as games produced by third-party companies on a platform called Steam. In addition to Steam, Valve hosts a community-driven market called Steam Marketplace where members can buy, sell, and trade digital items such as games and cosmetic effects. Plaintiffs in this case, minor children, who use Steam Marketplace, and their parents, are suing Valve for allegedly supporting “‘illegal gambling’ by ‘allowing millions of Americans, including Plaintiffs, to link their individual Steam accounts to third-party websites’ and by ‘allowing third-party sites to operate their gambling transactions within Steam marketplace.’” Valve responded by filing a motion to compel arbitration as conspicuously set forth in the Steam Service Agreement that one must accept to set up and use a Steam Account. Recall question 2, where you explained what the obligations of a minor who chooses to disaffirm a contract are. Do you think the minor plaintiffs in this case can preclude the arbitration clause by disaffirming the agreement? Why or why not? Do you think the arbitration clause in the Steam Service Agreement binds the minor’s parents to arbitrate? How do

you think the court should rule in this case? Source: GG v. VALVE CORPORATION, Dist. Court, (2017). Christopher Boling was seriously injured in 2008 when vapors escaping from a gas can ignited. He filed a products liability claim against the manufacturer. To fund the litigation, Boling entered into four agreements with Prospect Funding Holdings, LLC, to borrow funds totaling $30,000. Each agreement provided that interest on the principal accrued at a rate of 4.99% per month. In 2014, Boling resolved his suit against the gas can manufacturer. Shortly thereafter, Prospect sent Boling a "Schedule of Purchases" asserting that Boling owed Prospect $340,405. Boling filed suit against Prospect in Kentucky, arguing that the four agreements were void and unenforceable under Kentucky statutes prohibiting usury. Kentucky's statute states, in relevant part, that the maximum permissible per annum rate of interest on a loan was 4% plus the rate of the Federal Reserve Bank in the relevant district or 19%, whichever is less. The Federal Reserve Bank's rate at the time was approximately 1%. Prospect argues that the agreements were not loans, so the usury statute does not apply. Do the math; did Prospect violate Kentucky's statute? How do you think the court ruled on the issue of whether the agree-ments were loans? Source: Boling v. Prospect Funding Holdings, LLC, 2019 WL 1858506 (6th Cir. April 25, 2019). Page 257 In November 2011, Rosemarie Roopchand made a $200,000 loan to Raheek Mohammed. The parties executed a promissory note stating that Mohammed would repay Roopchand the principle sum of $200,000 with interest at the rate of 100 percent for the term of the loan, i.e. 50 percent per year for two years. The note also included a provision where, if Mohammed was unable to make payments, his company, Medina Petroleum Corporation, would make Roopchand whole. Roopchand invariably filed an action against Mohammed, his wife, and Medina Petroleum after Mohammed failed to complete payment on the promissory note. In response, the defendants filed a motion for summary judgment on the ground that the terms of the loan were usurious. The court dismissed the case in favor of the defendants and Roopchand appealed. In its ruling, the appeals court stated that "where a loan agreement is usurious on its face, usurious intent will be implied and usury will be found as a matter of law." What do you think of this criteria? How would you define the limits of "usurious on its face"? In this particular case, the maximum interest rate allowed by the state for a loan was 16 percent. If the interest rate in the promissory note was 17 percent would it be "usurious on its face"? What about at 18 percent? 20 percent? 25 percent? How would this case be different if the loan had been made directly to Medina Petroleum Corporation? Source: Roopchand v. Mohammed, 154 AD 3d 986 (2017).

Rachel Nitka began working at a Chili's restaurant in November 2015. She was 17 years old at the time. In 2018, she filed a suit against Chili's parent company, ERJ, and two coworkers, alleging sexual harassment, sexual discrimination, and assault and battery. In response, ERJ sought to compel arbitration based on an agreement Nitka signed upon being hired in which she agreed to arbitrate all disputes related to her employment. Nitka argued that the arbitration agreement should not be enforced because she does not remember signing the agreement. Additionally, Nitka was a minor when she signed the agreement and now wishes to disavow the agreement. What do you think of Nitka’s arguments? Does the fact that Nitka does not remember signing the agreement mean she cannot be held to it? What about the fact that Nitka was a minor when she allegedly signed the agreement? Can Nitka disavow the agreement now? How should the court rule? Source: Nitka v. ERJ Dining IV, LLC, Case No. 18 cv 3279 (N.D. Illinois 2018).No. 18 cv 3279 (N.D. Illinois 2018).